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A Reappraisal of the Branch Banking Prohibition in West Virginia

Kurt E. Entsminger
West Virginia University College of Law

STUDENT NOTES

A REAPPRAISAL OF THE BRANCH BANKING PROHIBITION IN WEST VIRGINIA

INTRODUCTION

In enacting its State Banking Code the West Virginia Legislature stated that its intention was to "foster and promote sound and dynamic financial institutions and particularly banking institutions in the State in order to provide services to the public which are necessary and desirable for the economic, social and industrial health and development of the State."[1] This provision is very general, yet clearly the Legislature intended that its regulatory scheme insure that banking in this state serve as a means to its desired goal. In other words, to the extent the Legislature may have desired banking stability, the reason for this desire was not merely to provide for the preservation of the existing banks, but rather to benefit this state and its population. Unfortunately, the Legislature has lost sight of its original purpose. Instead of providing for the public needs and the overall state economy, much of the banking legislation in West Virginia seems intended only to protect the vested interests of the existing financial institutions.

The Legislature's failure adequately to consider the needs of the public and the state has led to its continuing refusal to abolish the prohibition of branch banking in West Virginia. West Virginia Code section 31A-8-12 provides that no banks in this state may install branches.[2] Although the Legislature has allowed the operation of one off-premises walk-in or drive-in facility located within 2,000 feet of a bank's main office,[3] it has repeatedly defeated bills aimed at more liberal branch banking laws.[4] Meanwhile, thirty-nine states and the District of Columbia allow some form of branch banking and the federal government has strongly indicated its preference for less stringent branching laws.[5]

[1] W. VA. CODE § 31A-1-1 (1978 Replacement Vol.).

[2] *Id.* § 31A-8-12.

[3] *Id.*

[4] The last two bills proposing the allowance of branch banking in West Virginia, House Bill 906 and Senate Bill 227, were introduced in the Legislature in January, 1979.

[5] Report of the President's Commission on Financial Structure and Regula-

The purpose of this note is to reexamine the rationale behind the prohibition of branch banking and to demonstrate that this rationale is both obsolete and economically unsound. Also, this article will attempt to show the substantial advantages that can be gained through the legalization of branch banking. Finally, a proposal will be made for new legislation dealing with branch banking in West Virginia.

BACKGROUND

In the early 19th century, branch banking in the United States enjoyed considerable growth and development. The Civil War marked the culmination of this era. As a result of a substantial number of Southern bank failures, economic depression, and the degeneration of Western banks into the market of "wildcat" currency, Congress saw a need for reform.[6] It enacted the National Bank Act of 1864, which called for a system of banks to be chartered by the federal government.[7] Branch banking was not an important issue in the debate of this Act, and the Act itself was silent on the point.[8] However, there was an implied outlawing of branch banking, as several clauses in the Act referred to "the place" where banking operations would be carried out and where the "banking house" would be located.[9] Subsequently, the Comptroller of the Currency interpreted the Act to be prohibitive of branch banking. Although state banks could still branch, further restrictive legislation was enacted in 1864 as Congress placed a tax on the issuance of bank notes by state banks.[10]

As a result of the new Congressional policy, the American banking structure after 1864 was relatively simple. Almost all banks had national charters, and therefore there were virtually no banks with branches. In the late 1880's, however, bankers found that profitable banking did not require the issuance of notes, caus-

tion 59-63 (Dec. 1971).

[6] M. FOSTER, R. RODGERS, J. BOGEN, & M. NADLER, MONEY AND BANKING 298 (4th ed. 1953) [hereinafter cited as FOSTER].

[7] The National Bank Act, ch. 106, 13 Stat. 99 (1864) (current version at 12 U.S.C. § 21 (1976)). Section 36 of Title 12, 12 U.S.C. § 36 (1976), which deals with branch banking, was not part of the original National Bank Act. *See* 12 U.S.C. § 38 (1976).

[8] *Id.*

[9] The National Bank Act, ch. 106, § 8, 13 Stat. 102 (1864).

[10] Internal Rev. Act, ch. 173, § 110, 13 Stat. 277 (1864).

ing a resurgence of state banks. In 1868 there were 250 state banks, while in 1900 there were 6,650.[11]

With the reappearance of state banking, improved communications, and growing economic demands, branch banking became prominent once again. In the early 20th century all banking thrived and the total number of banking offices grew until reaching a peak of 31,000 in 1922.[12] During the 1920's and 1930's, this trend was reversed as bank failures became common. The effect of this retrenchment of the banking system, however, was not as severe on branch banking as it was on unit banking. In fact, the total number of branch banks continued to grow from 530 in 1920 to 751 in 1930 to 959 in 1940.[13] Meanwhile, although their total number fluctuated, there was during this period an overall increase of over 250 percent in the number of branching offices from 1,281 in 1920 to 3,531 in 1940.[14] By 1939, thirty-six states allowed branch banking,[15] and by virtue of the McFadden Act national banks were permitted to branch to the extent that state law allowed.[16]

The West Virginia Constitution provides that the regulation of banking shall be left to the Legislature.[17] Branch banking has been prohibited in this state by statute since 1929, and as early as 1905 an Attorney General's opinion ruled it illegal.[18] The West Virginia Supreme Court of Appeals has held that the determination of what constitutes branch banking should be left within the province of the Legislature or the banking commissioner or board.[19] Although neither the Legislature, the banking commissioner, nor the banking board have provided specific guidelines to determine what constitutes a "branch bank," West Virginia Code section 31A-8-12 is broadly prohibitive in that it provides that except for the limited allowance of one off-premises walk-in or drive-in facil-

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[11] P. Horvitz, *Branch Banking, Mergers, and Competition*, in BANKING AND MONETARY STUDIES 306, 306 (D. Carson ed. 1963).

[12] *Id.* at 307.

[13] W. VA. RESEARCH LEAGUE, STUDY OF BRANCH BANKING, MERGERS, HOLDING COMPANIES, AND WEST VIRGINIA BANKING 33 (1970).

[14] *Id.*

[15] FOSTER, *supra* note 6, at 299.

[16] 12 U.S.C. § 36(c) (1976).

[17] W. VA. CONST. art. 11, § 6.

[18] 1929 W. Va. Acts, ch. 23, § 5; 21 Op. Att'y Gen. 63 (1906).

[19] Bank of Wheeling v. Morris Plan Bank & Trust Co., 155 W. Va. 245, 250, 183 S.E.2d 692, 695 (1971).

ity, banking institutions shall not "engage in business at any place other than its principal office in this State."[20]

As a consequence of this restrictive legislation, unit banking has prospered in West Virginia unthreatened by the competition of branch banking. The West Virginia banking structure has become one of limited competition, which in some rural areas has become totally monopolistic.[21] The net result is that the public and the state economy suffer. Studies have shown that relative to the national norm, banking convenience in West Virginia is inferior.[22] Furthermore, statistics show that West Virginia banks have failed adequately to support local private investment. In 1969 among the Southeastern Appalachian states, West Virginia banks ranked last in the percentage of loans in proportion to total assets.[23]

Today, thirty-nine states and the District of Columbia allow some form of branch banking. This may include statewide, countywide, or some other moderate type of branching.[24] A handful of

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[20] W. VA. CODE § 31A-8-12 (1978 Replacement Vol.).

[21] K. HAMILTON, THE IMPACT OF VARIOUS BRANCH BANKING TECHNIQUES ON THE BANKING STRUCTURE OF WEST VIRGINIA 71 (1975) [hereinafter cited as HAMILTON]. In 1974 among the counties in West Virginia which had only one commercial bank were Calhoun, Clay, Gilmer, Morgan, Pendleton, Webster, and Wirt.

[22] *Id.* at 94.

[23] W. VA. RESEARCH LEAGUE, STUDY OF BRANCH BANKING, MERGERS, HOLDING COMPANIES, AND WEST VIRGINIA BANKING 168-69 (1970).

[24] States which allow some form of branch banking include: Alabama [ALA. CODE § 5-1-19 (1975 Replacement Vol.)], Alaska [ALASKA STAT. § 06.15.290 (1962)], Arizona [ARIZ. REV. STAT. ANN. § 6-190 (1973 Replacement Vol.)], Arkansas [ARK. STAT. ANN. § 67-360 (Cum. Supp. 1977)], California [CAL. FIN. CODE § 500 (Deering 1978)], Connecticut [CONN. GEN. STAT. ANN. § 36-59 (West Supp. 1979)], Delaware [DEL. CODE ANN. tit. 5, § 770 (Cum. Supp. 1978)], District of Columbia [D.C. CODE ANN. § 26-103 (1973 Replacement Vol.)], Florida [FLA. STAT. ANN. § 659.06 (West Supp. 1979)], Georgia [GA. CODE ANN. § 13-203 (Cum. Supp. 1979)], Hawaii [HAW. REV. STAT. § 403-53 (Cum. Supp. 1978)], Idaho [IDAHO CODE § 26-301 (Cum. Supp. 1979)], Indiana [IND. CODE ANN. § 28-1-17-1 (Burns 1975)], Iowa [IOWA CODE ANN. § 524.1201 (West Supp. 1979)], Kentucky [KY. REV. STAT. § 287.180 (Cum. Supp. 1978)], Louisiana [LA. REV. STAT. ANN. § 6:54 (West 1951)], Maine [ME. REV. STAT. tit. 9-B, § 913(5) (West Supp. 1978)], Maryland [MD. ANN. CODE art. 11, § 65 (1976 Replacement Vol.)], Massachusetts [MASS. ANN. LAWS ch. 172, § 11 (Michie/Law. Co-op Supp. 1979)], Michigan [MICH. STAT. ANN. § 23.710 (171) (Cum. Supp. 1979)], Mississippi [MISS. CODE ANN. § 81-7-5 (1972 Replacement Vol.)], Nevada [NEV. REV. STAT. § 660.015 (1973)], New Hampshire [N.H. REV. STAT. ANN. § 384-B:2 (1968 Replacement Ed.)], New Jersey [N.J. STAT. ANN. § 17:9A-19 (West Supp. 1979)], New Mexico [N.M. STAT. ANN. § 58-5-3 (1978)], New York [N.Y. BANKING LAW § 105 (McKin-

states, including West Virginia, either entirely prohibit the operation of off-premises facilities, or allow only the limited operation of walk-in or drive-in facilities within a short distance from the main banking office.[25] There is a steady trend in this nation towards enacting more liberal state branching laws. Through the Hunt Commission the federal government has emphasized its support for the allowance of statewide branching.[26] Yet the West Virginia Legislature continues to ignore the demands of the present and steadfastly upholds its prohibition of branch banking, even though the foundation for this prohibition has long since eroded away.

THE RATIONALE BEHIND THE PROHIBITION OF BRANCH BANKING

There has been a variety of arguments advanced to justify the prohibition of branch banking. Some of these justifications were at

ney Supp. 1979)], North Carolina [N.C. GEN. STAT. § 53-62 (1975 Replacement Vol.)], North Dakota [N.D. CENT. CODE § 6-03-14 (1975 Replacement Vol.)], Ohio [OHIO REV. CODE ANN. § 1111.03 (Page Supp. 1978)], Oregon [OR. REV. STAT. §§ 714.030 et seq. (1977 Replacement Part)], Pennsylvania [PA. STAT. ANN. tit. 7, § 905 (Purdon Supp. 1979)], Rhode Island [R.I. GEN. LAWS § 19-1-13 (1968 Reenactment)], South Carolina [S.C. CODE § 34-1-70 (1976 Replacement Vol.)], South Dakota [S.D. COMPILED LAWS ANN. § 51-20-1 (Cum. Supp. 1978)], Tennessee [TENN. CODE ANN. § 45-443 (Cum. Supp. 1978)], Utah [UTAH CODE ANN. § 7-3-6 (1971 Replacement Vol.)], Vermont [VT. STAT. ANN. tit. 8, § 651 (1970 Replacement Vol.)], Virginia [VA. CODE § 6.1-39 (1979 Replacement Vol.)], Washington [WASH. REV. CODE ANN. § 30.40.020 (Cum. Supp. 1978)] and Wisconsin [WIS. STAT. ANN. § 221.04 (West Supp. 1979)]. Among the states which do permit branch banking there is little uniformity in the various provisions authorizing branching. Some states such as California and Nevada permit statewide branching. Other states such as Indiana and Kentucky permit only countywide branching. More moderate states such as Iowa and Georgia permit banks to branch in adjacent counties. Still others such as New Mexico and New Hampshire provide a certain mileage radius in which branching is allowed. These differences in geographical limitations are but one example of the many variations which exist among laws authorizing branch banking.

[25] These states include Colorado [COLO. REV. STAT. § 11-6-101 (Cum. Supp. 1978)], Illinois [ILL. ANN. STAT. ch. 16½, § 106 (Smith-Hurd Supp. 1979)], Kansas [KAN. STAT. § 9-1111 (Cum. Supp. 1978)], Minnesota [MINN. STAT. ANN. § 48.34 (West 1970)], Missouri [MO. ANN. STAT. § 362.107 (Vernon Supp. 1979)], Montana [MONT. REV. CODES ANN. § 5-1028 (Cum. Supp. 1977)], Nebraska [NEB. REV. STAT. § 8-157 (Cum. Supp. 1976)], Oklahoma [OKLA. STAT. ANN. tit. 6, § 501 (West Supp. 1978)], Texas [TEX. REV. CIV. STAT. ANN. art. 342-903 (Vernon Supp. 1978)], West Virginia [W. VA. CODE § 31A-8-12 (1978 Replacement Vol.)] and Wyoming [WYO. STAT. §§ 13-1 et seq. (1965 Replacement Vol.)].

[26] Report, *supra* note 5.

one time valid, but advances in technology or other changes have made them obsolete. Others have simply been proven to be unsound by research and reality. The arguments against branch banking are based on several "fears": (a) the fear that branch banks will be subject to communication problems and management incompetency, (b) the fear that the legalization of branch banking will result in the monopolization or concentration of money, (c) the fear that branch banking will cause instability in banking and an increase in bank failures, and (d) the fear that branch banking will result in a decrease of community input into banking and a drainage of local funds.

A. *Communications and Management*

The argument that branch banking will falter from communication problems or management incompetency should be dealt with only in conjunction with a history lesson in banking. But as is often the case when causes are put forth to maintain the status quo, some arguments manage to outlive their time.

Clearly, with modern telecommunications and the ability to transfer huge amounts of information over long distances in a short time, there is little room to worry that branch banking offices will lose touch with their main offices. This may have been a legitimate concern when people depended on cruder media for messages, but today the merit of this argument has long since vanished.[27] Furthermore, one Federal Reserve Board Governor, George W. Mitchell, foresaw the coming of technology "that not only will permit, but will force, profound changes in the banking structure."[28] The advent of computer banking terminals has made this prophecy a reality.

Closely related to the communications issue is the argument that branch banking results in incompetency of management, since the branch office is not subject to the same administrative safeguards as the main office. As in the previous communications argument, this reasoning clearly is obsolete. With the introduction of better communication systems, the physical presence of higher

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[27] Note, *Branch Banking in Colorado — A Proposal for Reform,* 48 DENVER L.J. 575, 580-81 (1971-72).

[28] Quantius, *Outmoded Aspects of Branch Banking Laws,* 204 COM. & FIN. CHRON. 9, 10 (1966).

management is no longer necessary to assure that administrative policy will be carried out.[29] Furthermore, a strong argument can be made that a branch banking system actually promotes more efficient use of management. In a unit banking system each bank, no matter how small, requires some form of executive management. However, in a branch banking system only the main bank offices require top management. Thus, branch banking increases management efficiency in two significant ways. First, since top management is a limited resource, branch banking, by reducing the number of top managers needed, can increase the average quality of all management. Second, top management will be placed only at the main bank office, causing the business of branch offices to become standardized under the administrative policies of the main office.[30]

B. *The Monopolization and Concentration of Money*

Perhaps the argument most often voiced against branch banking is that its allowance will lead to a concentration of money in a few large banking organizations, resulting in a monopoly of the money market. There is one initial fallacy in this argument. The word "monopoly" has been associated with corporate giants for so long that its true meaning has been forgotten. A monopoly is not measured by the absolute size of a business, but rather is gauged by the amount of competition within a market and the barriers to entry of potential competitors.

One author, recognizing that monopoly and bigness are not always synonymous, noted that single, small banks in small towns could be monopolistic.[31] In West Virginia, a very similar situation exists. Although the size of the average bank in terms of total assets is not large, the lack of existing competition and the artificial barriers to entry created by the banking laws have resulted in a situation in which many banks in West Virginia have little restraint upon their behavior in the local market. There are several large geographic areas in West Virginia which are served by one or very few banks.[32] One economic study has shown that excessive

[29] Note, *supra* note 27, at 581.

[30] FOSTER, *supra* note 6, at 300.

[31] Baker, *State Branch Bank Barriers and Future Shock — Will the Walls Come Tumbling Down?*, 91 BANKING L.J. 119, 123-24 (1974) [hereinafter cited as Baker].

[32] HAMILTON, *supra* note 21, at 71.

concentration of banking assets exists in 21 of West Virginia's 55 counties,[33] 15 of which were classified as rural.[34]

One result of this market structure can be seen in the population per bank office ratio, which in West Virginia is significantly higher than the national average. In 1972, the average ratio for the United States was 5,121 people per banking office. In West Virginia there were 8,773 people per banking office.[35] In a rural state this high ratio seems to represent a particularly acute customer inconvenience problem. Another result of such limited competition is that banks in West Virginia have tended to emphasize the payment of dividends rather than increasing bank capital to meet the demand for loans.[36] One graphic example of the effect of limited competition on a bank's willingness to provide loans may be illustrated by the comparison of two national banks in West Virginia. In 1974, the Webster Springs National Bank was the only commercial bank located in Webster County. This county has an area of 558 square miles and a population of approximately 10,000. The loans made by this bank represented only 31 percent of its total assets.[37] Meanwhile, the Charleston National Bank, which faced competition from 16 other banks in Kanawha County, invested 66 percent of its total assets in loans.[38]

The argument that concentration and monopoly will result from branch banking does not withstand evidence gathered from several prominent studies which have shown that branch banking actually results in greater competition.[39] There are several reasons for this. First, to the extent that a monopoly already exists under a unit banking system, the allowance of branch banking serves to introduce competition.[40] Where there is only one bank serving a community, the potential or actual introduction of a branch office

[33] *Id.* at 158.

[34] *Id.* at 161.

[35] *Id.* at 94.

[36] *Id.* at 160.

[37] W. VA. DEPT. OF BANKING, REPORT OF COMMISSIONER 130 (1974). The Webster Springs National Bank had total assets in the amount of $9,767,172 of which $3,039,779 was invested in loans.

[38] *Id.* at 116. The Charleston National Bank had total assets in the amount of $433,617,335 of which $288,365,715 was invested in loans.

[39] Baker, *supra* note 31, at 125-28; B. Shull & P. Horvitz, *Branch Banking and the Structure of Competition*, NATIONAL BANKING REV. (March 1964).

[40] Baker, *supra* note 31.

by another bank creates more competition. Considering the number of geographic areas in West Virginia which are now monopolistic, one may conclude that branch banking will help to increase competition in the state's banking structure. Second, the advent of branch banking does not necessarily mean the elimination of unit banking. Studies have shown that well-managed unit banks are able to operate profitably despite the competition of a local branch office.[41] And third, branch banking may allow the profitable operation of a branch office in an area where losses would have been inevitable for a unit bank.[42] Unlike a unit bank, which must maintain a balance between deposits and loans, a branch office possesses more flexibility and may serve primarily to collect deposits or extend credit, depending on local needs. Also, through the centralization of management over several branches and as a result of other economies of scale, the initial capital required to open a branch office may be significantly less than that required to open a unit bank.

Along with national studies which have shown that branch banking will not result in a significant increase in monetary concentration, there has been a specific study recently conducted in West Virginia.[43] Utilizing modern tools of quantitative economics, the author developed a set of simulation models to project how the structure of banking in West Virginia would change under more liberal branching laws. The findings indicated that with the introduction of branch banking there would be no dramatic increase in concentration of bank assets.[44]

The possibility of predatory pricing by branch banks presents one area which gives rise to a legitimate concern for potential concentration of money.[45] The utilization of geographic price discrimination by branch banks could very easily force efficient unit banks out of business. Such predatory pricing is effected by a branch bank temporarily setting its prices in the form of interest rates at or below costs at an office which is in direct competition

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[41] P. Horvitz, *Branch Banking, Mergers, and Competition*, in BANKING AND MONETARY STUDIES 306, 315 (D. Carson ed. 1963).

[42] *Id.* at 310.

[43] HAMILTON, *supra* note 21.

[44] *Id.* at 162.

[45] P. Horvitz & B. Shull, *Branch Banking, Independent Banks and Geographic Price Discrimination*, 14 ANTITRUST BULL. 827 (1969).

with a unit bank. The branch bank can make up for these short-term losses by charging higher prices at other branch offices which face less competition.[46] If the branch bank is allowed to continue this practice it can systematically eliminate its competition. Obviously this result is not desirable.

One means of preventing geographic price discrimination already exists in the form of anti-trust laws.[47] It is unlikely, however, that anti-trust laws by themselves can be totally successful in preventing branch banks from utilizing predatory pricing. More specifically, legislation in branching states could be implemented to require price uniformity at all branch offices of a branch bank.[48] This solution seems desirable since it deals directly with the potential problem of geographic price discrimination and would be easier to enforce than anti-trust legislation. One further, more general check on the potential concentration of money can be obtained through legislation which would place a fixed percentage limitation on the proportion of total state deposits a bank organization could acquire. Some branching states have already enacted this type of legislation.[49]

Finally, there is some fear voiced that the allowance of branch banking in this state would naturally lead to the establishment of branches in West Virginia by the larger banks of neighboring states. The result arguably would be that money of West Virginia depositors would ultimately become concentrated in a few banks of foreign states. A proposal to permit branch banking in West Virginia can, however, easily be limited to banking institutions within this state. In fact, West Virginia Code section 31A-1-2(b) sets forth the definition of a "bank" or "banking institution" as "a corporation . . . chartered to conduct a banking business in West Virginia or an association . . . authorized to conduct a banking business in West Virginia under the laws of the United States and having its principal office in this State. . . ."[50] Therefore, any authorization given by the Legislature for banks or banking institutions to branch in this state is inherently limited to corporations

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[46] *Id.* at 835.

[47] 15 U.S.C. §§ 13-13(b) (1976); W. VA. CODE § 47-18-4 (Cum. Supp. 1979).

[48] P. Horvitz & B. Shull, *supra* note 45, at 840.

[49] IOWA CODE ANN. § 524.1802 (West Cum. Supp. 1979); N.H. REV. STAT. ANN. § 384-B:2 (1968 Replacement Ed.).

[50] W. VA. CODE § 31A-1-2(b) (1978 Replacement Vol.).

chartered in this state or national banks having their principal office in this state.

C. *Stability in Banking*

The probable reason for continued public sensitivity to the degree of banking stability is the lingering remembrance of the devastating effects of the widespread occurrence of bank failures in the early years of the Great Depression. Although one cannot deny the drastic impact of those failures, today public fear of banking instability or widespread bank failure is hardly warranted. Proponents of the prohibition of branch banking, however, continue to argue that branch banking will destroy banking stability.

The strength of this argument seems to rely more upon emotional appeal than logic. First, from a depositor's point of view there is little reason for fear of banking instability. In 1933 the Federal Deposit Insurance Corporation was formed and today insures deposits up to 40,000 dollars.[51] Ninety-nine percent of all depositors are fully protected.[52] Second, the absolute number of bank failures in recent years has been minimal compared with the Depression years. Between 1930 and 1933 there were 7,763 bank failures, while between 1946 and 1970 there were only 252.[53] And third, branch banking should not be held the culprit for recent bank failures. Studies show that well-managed small unit banks are able to compete successfully with larger branch banks, while most recent bank failures are due not to excessive competition but rather to poor management.[54]

D. *Local Needs*

The proposition that branch banking will be less responsive to the local needs of a community is based on two arguments. First, it is asserted that because a branch office is part of a larger system controlled by policy dictated at a distance, local service will become depersonalized and less geared toward local needs. The second argument is that a branch office will swallow up local funds

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[51] 12 U.S.C. § 1821 (1976).

[52] D. KAMERCHEN & E. KLISE, MONEY AND BANKING 137, n. 13 (6th ed. 1976). Sixty percent of the total dollar value of total deposits are protected.

[53] *Id.* at 59.

[54] Baker, *supra* note 31, at 124.

for investment at other locations, making local loans difficult to obtain.

In our society there is a legitimate and growing resentment toward the depersonalized and insensitive nature of modern business interaction. This is not a major problem in relation to branch banking. Studies have shown that when branch banking is permitted in an area the population per banking office may substantially decrease.[55] Thus, branch banking may increase the degree of personalized service. Also, although executive administrative policy may be derived from a distance, local management of a branch office may still maintain the requisite flexibility to tailor properly its services to conform with local demand. Indeed, if there is competition from other banks, response to local needs may be mandatory to insure profitable survival. Additionally, some of the onus of depersonalization and community distance from the main office can be negated by the institution of hiring and management development policies which incorporate employment opportunities for local residents.

The fact that a unit bank is locally owned does not necessarily justify the conclusion that it will remain sensitive to local demands. The interests of a small number of stockholders may not correspond to those of the general community.[56] This may be particularly true in West Virginia, where one economist noted that in counties where there is little competition, "market power is being manifested in the payment of dividends rather than in the making of provisions to increase bank capital and, thus, the ability of the bank to service customers requesting large loans."[57]

The overall availability of local loans may be greater in a branch banking system. Because branch banks usually possess more total assets than unit banks, they are better able to meet the demand for larger loans. In a unit banking state the fragmentation of capital may greatly limit the banking industry's ability to meet the credit requirements of basic industries. Moreover, statistics show that branch banks devote a larger percentage of their total assets to loans. In 1969, among 13 Southeastern states, West Virginia and Florida, the only two unit banking states in the region,

[55] HAMILTON, *supra* note 21, at 94.
[56] Note, *supra* note 27, at 582.
[57] HAMILTON, *supra* note 21, at 160.

ranked last in the percentage of total bank assets loaned out.[58] Finally, the claim that branch banking will result in a drainage of local funds has not been borne out. The relative availability of local loans has not been proven to be less in branch banking states. In fact, large banks in states which allow branching make a much greater proportion of their business loans in local markets than similar size banks in unit banking states.[59]

ADVANTAGES OF BRANCH BANKING

In West Virginia there are 228 banks with an approximate average of 36 million dollars in assets. Only 16 banks in West Virginia have over 100 million dollars in assets, and of the 300 largest commercial banks in the United States, this state has none. Meanwhile, in the five states which border West Virginia, all of which allow some form of branching, the average total assets per bank is 111 million dollars, and of the 300 largest commercial banks in the United States, these states have 59.[60] In considering West Virginia's economy, which historically has been plagued by lagging growth and absentee ownership, these statistics become very revealing. Although it may be difficult to identify clearly a strong causal relationship between West Virginia's banking structure and its economy, it is logical to believe that at least to some degree the substantial lack of local private investment in this state can be attributed to the relative scarcity of local financial resources.

The potential impact of banks on regional economic growth was recognized by one author who stated that:

[58] W. VA. RESEARCH LEAGUE, STUDY OF BRANCH BANKING, MERGERS, HOLDING COMPANIES, AND WEST VIRGINIA BANKING 168-169 (1970).

[59] R. Eisenbeis, *The Allocative Effects of Branch Banking Restrictions on Business Loan Markets,* JOURNAL OF BANK RESEARCH 43, 47 (Spring 1975).

[60] POLK'S WORLD BANK DICTIONARY vii-ix (N. Am. ed.) (Fall 1978). The figure for average assets was determined by taking the total assets for all banks in West Virginia ($8,254,563,979) and dividing that number by 228, the number of banks in this state. The five states which border West Virginia are Ohio, Pennsylvania, Kentucky, Maryland, and Virginia. The figure for average assets for these combined states was derived by adding the total number of banks for these states and dividing that figure into the total assets for these states. Of the 300 largest commercial banks in this country, Ohio has 15, Pennsylvania has 25, Kentucky has 4, Maryland has 7, and Virginia has 8.

> [C]ommerical banks, which operate the payments mechanism, play a central role in the regional growth process. Not only do "almost all" payments internal to the area pass through the books of that area's commercial banks, but in addition so do most interregional payments. In the process these interregional payments affect commercial bank reserves and deposits and the banks' ability to hold local and national earning assets.[61]

In his discussion the author goes on to say that the monetary base of a growing region must increase and then "an increase in local loans, especially to business, finances a rise in local spending, output and income. Increased bank lending tends to generate a wave of expansion of local income."[62]

The allowance of branch banking may facilitate economic growth in several ways. First, branch banking leads to an increase in the average total assets per bank. Banks with the ability to expand into new markets through branching can accumulate a greater pool of assets. This increases both the number and level of investment possibilities as large loans become more available. Currently the average total assets of West Virginia banks is only one-third of the average for banks in the bordering states which permit branching.[63] Second, statistics show that branch banking results in a greater proportional allocation of assets to loans as opposed to investment in United States treasury obligations.[64] For example, in 1969 the average ratio of loans to total assets for West Virginia banks was 46.4 percent.[65] In Virginia, a neighboring state which allows branch banking, the ratio was 57.3 percent. Meanwhile, West Virginia's level of investment in United States treasury obli-

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[61] CALIFORNIA BANKING IN A GROWING ECONOMY: 1946-1965, 93 (H. Minsky ed. 1965) quoted in G. DREESE, BANKS, BANKERS AND ECONOMIC GROWTH IN APPALACHIA at 19 (1973).

[62] CALIFORNIA BANKING IN A GROWING ECONOMY: 1946-1965, 94 (H. Minsky ed. 1965) quoted in G. DREESE, BANKS, BANKERS AND ECONOMIC GROWTH IN APPALACHIA at 19 (1973).

[63] *See* note 60.

[64] *See* W. VA. RESEARCH LEAGUE, STUDY OF BRANCH BANKING, MERGERS, HOLDING COMPANIES, AND WEST VIRGINIA BANKING 168-169 (1970). In 1969 West Virginia and Florida, the only two unit banking states in the region, reflected the lowest ratios of loans to assets among Southeastern states. Meanwhile, the ratios of investment in treasury obligations to assets for these two states were significantly higher than the regional average.

[65] *Id.*

gations was nearly double the national average.[66] This indicates that branch banking may lead to a significant increase in the level of total local investment. Furthermore, the effect of a more liberal loan policy upon a local economy may be additionally augmented by reason of the "multiplier effect." Subject to reserve requirements, commercial banks may loan out a large proportion of deposits and, thus, through loans, banks have the virtual ability to create money. When a bank makes a loan in a local market, the money lent is deposited which in turn provides for additional loans. As this process continues, the local money supply is increased by a multiple amount of the sum initially loaned. And third, with branch banking there is a greater mobility of capital. Deposits made at one branch office can be used to stimulate investment through loans made at other offices of the same banking organization. The interregional movement of funds promotes overall bank loan growth and allows for the generation of investment where it is most needed.

One of the potential advantages of branch banking rests in the substantial increase it may provide in public convenience. In states where branching is permitted, the population per bank office is substantially less than in unit banking states. Currently the ratio in West Virginia is approximately 7,700 people per banking office. In Virginia, the ratio is about 3,100 people per office.[67] Furthermore, branches can often operate profitably in communities unable to support a unit bank. One author explains:

> [T]he branch can operate mainly as a collector of deposits or as an extender of credit, while a unit bank must maintain some balance between deposits and loans. The branch bank already has experienced personnel who can be shifted to the new branch. The new branch need cover only direct costs of its operations, at least at first. That is, it does not need to earn enough to cover officers' salaries, or even the expenses of maintaining an investment department or a credit department, as these exist in the head office already. If initial losses must be borne

[66] *Id.* In 1969 the national average was 11.8%, while in West Virginia the average was 21.1%.

[67] POLK'S WORLD BANK DICTIONARY vii (N. Am. ed.) (Fall 1978). These figures are derived from taking the population of the respective state and dividing that number by the number of banking offices within the state. The population of West Virginia is 1,744,237 and there are 228 commercial banking offices in this state. In Virginia the population is 4,648,494 and there are 1,483 banking offices.

while the bank is establishing its place in the community, the branch bank can probably better afford these than a new small unit bank.[68]

The practical effect of branch banking, therefore, is to provide greater proximity of banking services for the average consumer. In a rural state such as West Virginia, the improved convenience of multiple banking locations is very desirable. Furthermore, as the number of banking offices increases in rural areas, the average individual should have a significantly greater number of banking choices.[69]

Perhaps, though, the greatest convenience resulting from the allowance of branch banking would come simply from its freeing of modern banking technology to operate most efficiently. Customer-bank-communication-terminals (CBCT's) have a tremendous potential for increasing banking convenience. CBCT's are recently invented electronic terminals which permit an existing bank customer to accomplish various financial transactions, including the deposit and withdrawal of funds and the transfer of funds between accounts. These automated tellers may be installed in shopping centers, stores, factories, and office buildings, and may permit customers to effect transactions at any time of the day or night. One author who recognized the great potential for CBCT's stated:

> [W]hat we have here are the fruits of important new technology which can offer the retail banking customer the convenience of a nearby 24-hour facility. The public should not be denied these competitive benefits simply because their introduction may be inconvenient to banks which already have offices in the market. Law, state or federal, should not be used to hold back beneficial technology.[70]

In West Virginia, however, under both federal and state standards, CBCT's may be prohibited except where installed at existing bank facilities.

Although the federal government has indicated its preference for liberal branching laws, the McFadden Act authorizes national

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[68] P. Horvitz, *Branch Banking, Mergers, and Competition,* in BANKING AND MONETARY STUDIES 306, 310 (D. Carson ed. 1963).

[69] *See* P. Jessup & R. Stolz, *Customer Alternatives Among Rural Banks,* JOURNAL OF BANK RESEARCH 135-139 (Summer 1975).

[70] Baker, *supra* note 31, at 131.

banks to establish branches only where state law permits.[71] However, the Supreme Court has ruled that in determining what constitutes a "branch" of a national bank, federal law must govern.[72] Under the McFadden Act, the definition of a "branch" is very broad, incorporating "any branch bank, branch office, branch agency, additional office, or any branch place of business . . . at which deposits are received, or checks paid, or money lent."[73] Employing this definition, the federal circuit courts which have ruled on this issue have held that CBCT's constitute branches under federal law.[74] Under state law, CBCT's clearly fall within the broad scope of West Virginia Code section 31A-8-12 which, subject to one off-premises exception, prohibits branch banking and the engaging in business by a banking institution "at any place other than its principal office in this State."[75] Therefore, as long as the prohibition of branch banking persists in West Virginia, the public will be forced to bank without the substantial convenience of these computer terminals.

The allowance of branch banking may also lead to an overall improvement in the diversity and quality of banking services. This may be partially attributed to the greater economies of scale and competition realized through branch banking. With larger pools of both human and capital resources, branch banks are better able than unit banks to offer a wide range of services at lower costs. Also, the increased competition generated through branch banking helps create more incentive for all banks to respond adequately and efficiently to individual customer needs.

Not only may branch banking contribute to an increase in the diversification, quality, and convenience of banking services, it may at the same time provide lower prices and greater returns to customers. One study has shown that branch banking provides greater services, more banking facilities, larger lending power, and

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[71] 12 U.S.C. § 36(c) (1976).

[72] First Nat'l. Bank v. Dickinson, 396 U.S. 122 (1969).

[73] 12 U.S.C. § 36(f) (1976).

[74] Illinois *ex rel.* Lignoul v. Continental Ill. Nat'l. Bank & Trust Co., 536 F.2d 176 (7th Cir. 1976); Missouri *ex rel.* Kostmen v. First Nat'l. Bank, 538 F.2d 219 (8th Cir. 1976); Colorado *ex rel.* State Banking Bd. v. First Nat'l. Bank, 540 F.2d 497 (10th Cir. 1976); Independent Bankers Ass'n. v. Smith, 534 F.2d 921 (D.C. Cir. 1976).

[75] W. Va. Code § 31A-8-12 (1978 Replacement Vol.).

greater public convenience, and also results in lower loan rates for borrowers and higher savings interest for depositors.[76]

PROPOSAL FOR LEGISLATIVE CHANGE

The time for reform of West Virginia law in the area of branch banking has long been overdue. The following proposal would amend the West Virginia Code to permit statewide branching.

The first proposed legislative section would add to the State Banking Code a section defining a "branch office" which would essentially adopt the federal definition of a "branch,"[77] but would explicitly exclude CBCT's from this definition. A separate provision authorizing the use of CBCT's is proposed at the end. This exclusion would prevent the great potential of this unique and modern technology from being stifled by other branch banking limitations. The remainder of the proposed legislation is aimed toward allowing statewide branch banking, subject to certain limitations. Among the limitations is a provision that no branch office shall be installed unless there is a finding that this installation will promote public convenience. This requirement would help insure that the introduction of a branch office would be beneficial to the community in which it proposes to operate. Also, there is a limitation on the total deposits which any banking institution could obtain in order to prevent the advent of branch banking from resulting in an unreasonable concentration of money. Lastly, there is a limitation which provides for uniform pricing by all branches of a single banking institution. This limitation is intended to restrain branch banks from predatory pricing. The proposal would not alter West Virginia Code sections 31A-8-12(b) and (c);[78] thus, these sections are omitted below. The proposed changes are as follows:

1. A clause should be added to West Virginia Code section 31A-1-2 to read:

(p) The word "branch office" means any branch agency, additional office, or any branch place of business maintained by a

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[76] NEW YORK STATE BANKING DEPT., BRANCH BANKING, BANK MERGERS, AND THE PUBLIC INTEREST (1964).

[77] 12 U.S.C. § 36(f) (1976).

[78] W. Va. Code §§ 31A-8-12(b), (c) (1978 Replacement Vol.).

banking institution, other than its principal office, at which deposits are received, or checks paid, or money lent, but shall not include customer-bank-communication-terminals maintained by banking institutions having their principal office in this State.

2. West Virginia Code section 31A-8-12 should be amended to read:
Branch banks authorized; limitation on purchase of bank stock and control.

(a) When so authorized a banking institution, pursuant to a resolution of its board of directors, may establish one or more branch offices within the State provided that:

(1) No banking institution shall install or maintain a branch office unless the West Virginia board of banking and financial institutions approves an application for such branch office based upon findings that public convenience and advantage will be promoted by the establishment of such branch office, that local conditions assure reasonable promise of the successful operation of such branch office, that the capital structure of the applicant is adequate to support the operation of such branch office, and that provision has been made to provide suitable banking quarters for such branch office.

(2) No application for a branch office shall be approved if upon the most recent data, reports, and information compiled by the commissioner it is reasonably shown that the banking institution making such application has acquired through its offices, including its principal office, an aggregate of more than ____ percent[79] of the

[79] The author has purposely chosen not to propose a specific numerical limitation on the percentage of total state deposits which a bank may acquire before further branching will be prohibited. Undoubtedly, if this type of provision is proposed before the Legislature, there will be considerable debate as to what percentage limitation, if any, is desirable. Indeed, it may be argued that in light of other legal and economic safeguards available to prevent excessive concentration, this type of provision would be redundant and unnecessary. On the other hand, such a limitation would provide a direct check against large banks bent on eliminating competition.

To shed more light on this question, it may be appropriate to look at the status of large banks in West Virginia and two neighboring branch banking states in regard to the percentage of total state deposits which they currently possess. Actotal deposits, both time and demand, of all banks in this State.

(3) No branch office shall set, maintain, or pay a level of interest on savings deposits different from the level maintained and paid at the principal office of such branch office, provided, however, any branch office acquired through merger shall be permitted a reasonable period not to exceed three months from the time of acquisition, to adjust the level of interest on savings deposits to conform to the level paid by its principal office.

3. A new statutory provision should be enacted providing: *Customer-bank-communication-terminals authorized.*

A banking institution may make available for use by its customers one or more electronic devices or machines through which the customer may communicate to the banking institution a request to withdraw money from his account or an instruction to receive or transfer funds for the customer's benefit. The device may receive or dispense cash in accordance with such a request or instruction. Any transactions initiated through such a device shall be subject to verification by the banking institution either by direct wire transmission or otherwise. Such facilities may be unmanned or manned. These devices shall be designated as customer-bank-communication-terminals (CBCT's).

The establishment and use of a CBCT is subject to the following limitations:

(a) Written notice must be given to the commissioner no less than thirty days before any CBCT is put into operation. Such notice shall describe with regard to the communication system:

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cording to Polk's World Bank Dictionary, (N. Am. ed.) (Fall 1978), the largest bank in West Virginia in total assets is the Kanawha Valley Bank. With $275,583,249 in deposits, this bank has accumulated approximately 4% of the total deposits in this state ($7,106,199,187). The Virginia National Bank is currently the largest bank in Virginia and ranks 55th among all commercial banks in the United States. This bank has accumulated $1,833,973,114 in deposits which represents 11% of the total deposits in Virginia ($17,391,216,420). The 16th largest bank in the nation and the largest bank in Pennsylvania is the Mellon Bank, which has acquired $7,412,746,000 in deposits. It is interesting that this bank has acquired more deposits than all banks combined in West Virginia. Nevertheless, this amount represents only 11% of the total deposits in Pennsylvania ($68,819,706,633).

(1) The location;

(2) The manner of installation;

(3) The manner of operation; and

(4) The kinds of functions which will be performed.

(b) The functions of the CBCT shall be limited to:

(1) The receiving of deposits;

(2) The cashing of checks;

(3) The dispensing of cash;

(4) Payment of loan proceeds on a prearranged line of credit;

(5) Receiving loan payments; and

(6) The communication of other such information directly related to the customer's account.

(c) A banking institution shall provide insurance protection for transactions involving such devices.[80]

CONCLUSION

In West Virginia the public has been forced to sacrifice and the state economy has long suffered as a result of banking legislation enacted to hold back the clock and protect the established interests of a few. The traditional reasons given for the prohibition of branch banking have been proven unsound, and today the advantages of branch banking are clear. If the Legislature insists on maintaining its current stand, the people of this state will continue to pay a substantial price through higher loan rates, lower return on deposits, greater inconvenience, and poorer and less diversified services. Furthermore, this state's crippled economy will continue to ail from gross underinvestment. Today the need for change is great, and as the public grows more impatient, one may only hope that the Legislature will at last respond to those interests it once deemed so important.

Kurt Entsminger

[80] The statutory proposal authorizing the use of CBCT's is modeled after IDAHO CODE § 26-309 (Cum. Supp. 1979).